


City of Alexandria, Virginia

MEMORANDUM

DATE: JUNE 18, 2008

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER 

SUBJECT: MODIFICATION TO THE CITY'S DEBT RELATED FINANCIAL POLICIES:
DEBT PER CAPITA AS A PERCENT OF PER CAPITA INCOME

ISSUE: Modifying the City's debt policy guidelines for debt per capita as a percent of per capita income.

RECOMMENDATION: That City Council modify the City's Debt Policy Guideline for debt per capita as a percent of per capita income from a target of 2.25 percent and a limit of 3.25 percent, to a target of 3.2 percent and a limit of 4.5 percent debt as a percent of total personal income.

BACKGROUND: The City's Debt Related Financial Policies were initially adopted on June 9, 1987. These guidelines when they were adopted in 1987 were considered innovative by the bond rating agencies, and those debt related financial policies have been used as a model by other localities. The policies were substantially updated on December 9, 1997. With the exception of a minor change in 1999,¹ these policies have continued to guide City Council and staff in determining the debt capacity of the City, managing the impact of debt service on the operating budget, and maintaining adequate fund balances to cope with unexpected financial problems or emergencies. A copy of the policies is detailed in Attachment I.

DISCUSSION: The City Manager's proposed budget for FY 2009 outlined a proposal to change one debt policy guideline – the ratio of debt outstanding per capita to the total per capita personal income of Alexandrians.² This ratio changes each year to reflect the amount of debt outstanding as well as the total personal income of Alexandrians as measured by the Federal Commerce Department Bureau of Economic Affairs (BEA).

¹ On October 26, 1999, City Council modified the policies to allow priority consideration for an increase in the designation of fund balances for pay-as-you-go cash capital project funding when additional General Fund revenues become available at the end of the fiscal year.

² For simplicity, it is proposed that the ratio be changed from debt per capita as a percent of per capita personal income, to debt as a percent of total personal income. There is no mathematical difference between the results of the two ratios.

The Budget and Fiscal Affairs Advisory Committee has examined this issue on several occasions and said in its most recent report:

The marked increase in real property values in recent years was the basis for our prior recommendation that the debt policy guidelines related to personal income be recalibrated. We note that the City Manager is recommending an upward adjustment to the guidelines on debt as percentage of real property values. (See FY 2009 Budget Overview, 4-16). We continue to support this recalibration to ensure the relevance and usefulness of the guidelines.³

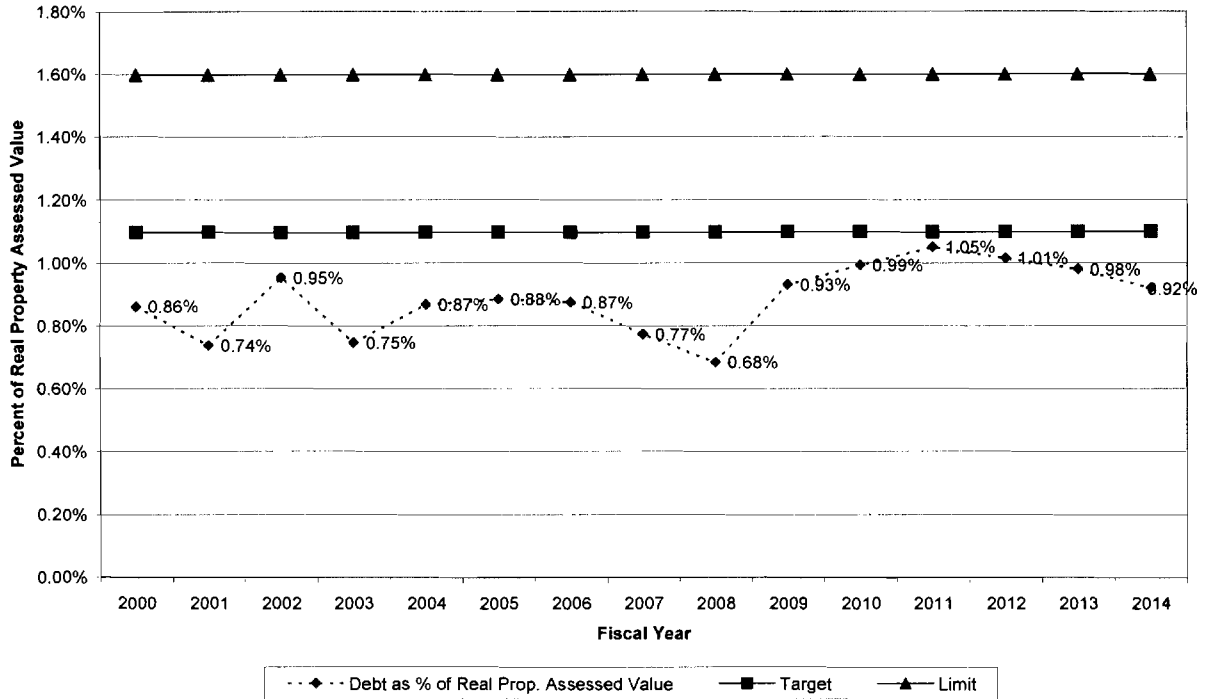
This recommended change in the debt policy guidelines is consistent with Council's Strategic Plan Goal 6: A City government that is financially sustainable, efficient and community-oriented.

City staff note that the single most important benchmark examined and watched by the rating agencies is that of debt as a percent of total assessed real property market value. One reason for revising the target and limit for debt as a percent of personal income is to synchronize these two guidelines to produce more similar results.

Our most current estimates of the City's performance against this benchmark is shown in the graph below which shows these ratios from FY 2000 through FY 2014 under the approved Capital Improvement Program for FY 2009 – FY 2014.

³ Budget Memo #93: Budget and Fiscal Affairs Advisory Committee (BFAAC) Review of the FY 2009 Proposed Budget, p. 25.

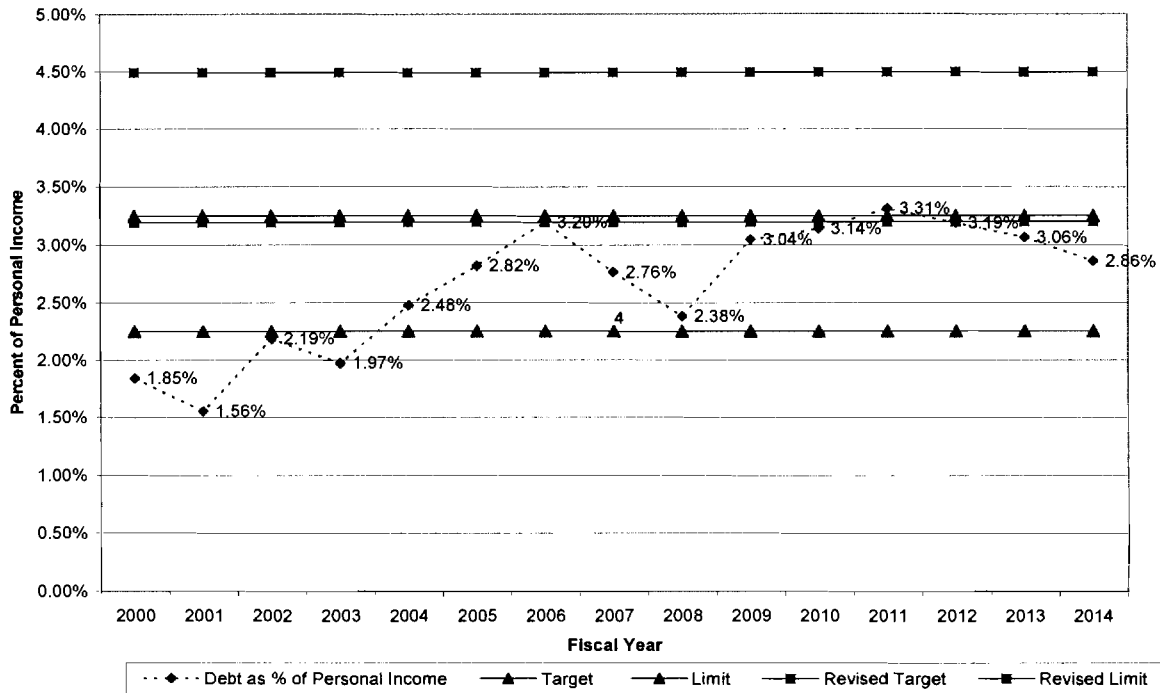
**Approved CIP FY 2009-2014
Debt as Percent of Real Property Assessed Value**



The next graph below shows debt as a percent of personal income. (The ratios are a combination of actual data from BEA and City projections for the future. The methodology is explained in the accompanying footnote⁴.)

⁴ Debt Outstanding reflects actuals are available through the end of FY 2008. It reflects expected debt issuances in FY 2009 through FY 2014 and actual and expected debt principal repayment schedules as shown in the Capital Improvement Program budget document. Debt for sanitary sewer projects is subtracted from total debt because these projects are supported by their own dedicated source of funding. Personal income is based on data provided by the BEA most recently available through FY 2006. Personal income estimates beyond FY 2006 are based on the average rate of growth in the past 5 years (2001 to 2006) of 6.45%.

**Approved CIP FY 2009-2014
Debt as Percent of Personal Income**

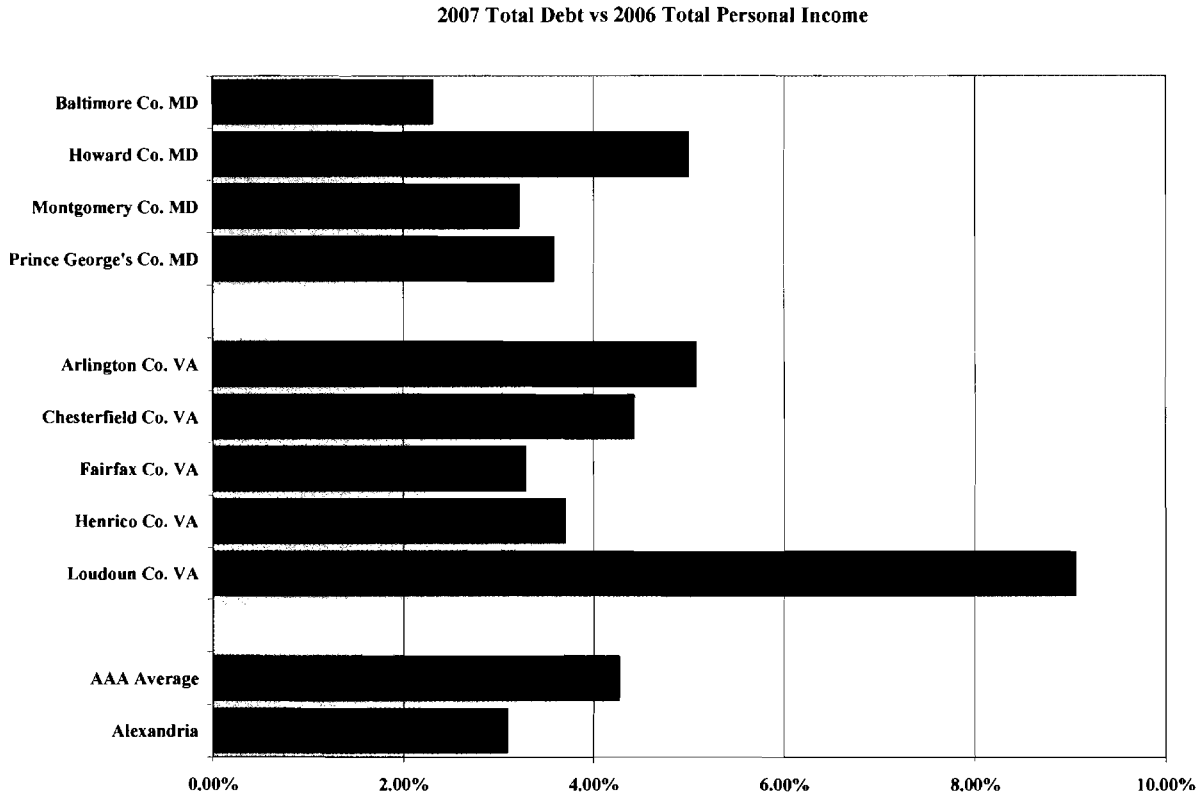


Another compelling argument for changing the debt policy guideline is that benchmarked against other triple A rated jurisdictions (i.e., AAA or Aaa), the City can issue more debt and still maintain its triple A rating. The City’s financial advisor, Davenport & Company, has provided a comparison of the City’s ratio of total debt outstanding as of the end of FY 2007 to 2006 total personal income for a number of other jurisdictions in the Washington area that also have at least one Triple A bond rating.⁵

⁵ All jurisdictions listed except Prince George’s County have at least two triple A ratings. Prince George’s County only has one AAA rating (Standard & Poors).

Alexandria's ratio of 3.09%⁶ compares favorably to an average for all jurisdictions of 4.27%. Based on this analysis, City staff believes that compliance with a limit of 4.5% and certainly with a target of 3.2% would be consistent with a Triple A bond rating.

The chart below shows how the City of Alexandria compares with other Triple A rated jurisdictions in the greater Washington area.

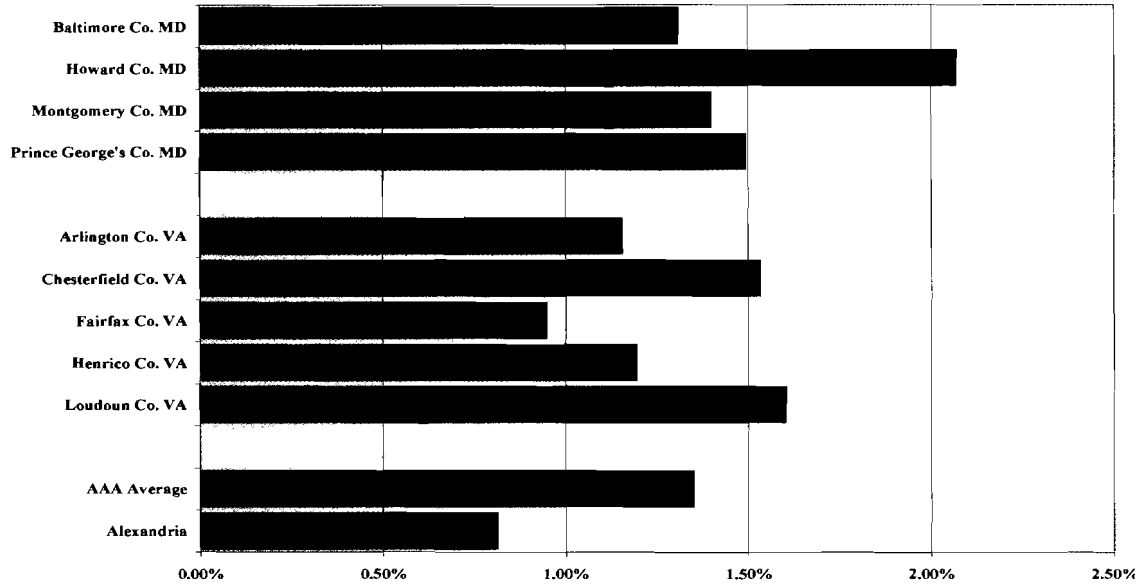


For additional comparisons of Alexandria's relative performance on other debt policy indicators benchmarked against the same jurisdictions by Davenport & Company, see the next page. No changes are recommended in the current targets and limits for these ratios of:

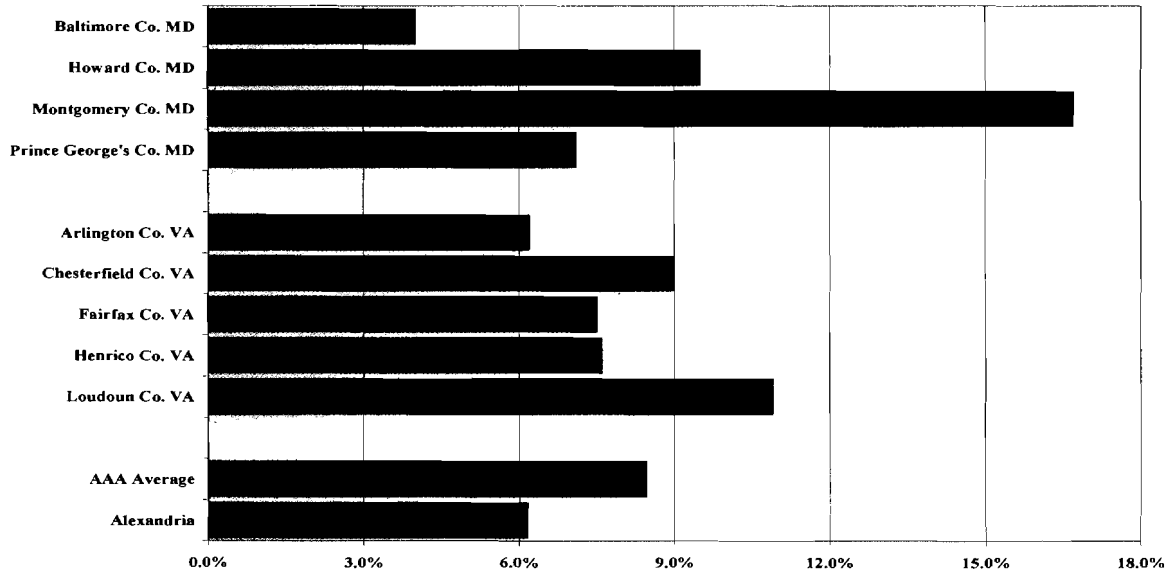
- 1.1% target and 1.6% limit for debt as a percent of total real property assessed value;
- 8.0 target and 10.0% limit for debt service as a percent of general expenditures.

⁶ For purposes of comparison, Davenport & Company used two different years that reflect the most recently available data for all jurisdictions for both data points. Note that on the previous time series chart for Alexandria, for FY 2007 the estimate for Alexandria is 2.76%. This number reflects the subtraction of sanitary sewer debt from the total debt and the estimation of continued growth in total personal income at a rate of 6.45% per year to reflect historical averages. These adjustments are not made by Davenport in order to provide valid comparisons.

Debt vs Market Value of Real Property



Debt Service as a % of Operating Expenditures



FISCAL IMPACT: There is no direct fiscal impact for this change, as we project no change in the bond ratings and the debt service costs of any future bond issuances.

ATTACHMENT: Debt Related Financial Policy Guidelines

STAFF:

Mark Jinks, Deputy City Manager

Bruce Johnson, Director, Office of Management and Budget

Laura Triggs, Director, Department of Finance

Debt Ratio Policies
Debt Related Financial Policies

City Council passed a set of debt-related financial policies on June 9, 1987. During FY 1998, the Budget and Fiscal Affairs Advisory Committee (BFAAC), a City Council appointed citizen committee, analyzed these debt-related financial policies, examined the City's financial condition in comparison to other jurisdictions with superior credit ratings (other double-triple A rated jurisdictions). The BFAAC and the City Manager recommended that City Council reaffirm the updated debt-related financial policies, incorporating BFAAC's recommended updates to the policies to establish a consistent set of appropriate relationships between debt targets and limits. Because three of the six debt indicators measure the debt capacity of the City in relation to the size of the City and its economy, BFAAC recommended that these indicators should not produce debt capacity limits that vary greatly from each other.

City Council reaffirmed its commitment to sound financial management and adopted the updated debt-related financial policies on December 9, 1997. City Council amended the policies on October 26, 1999, to allow priority consideration for an increase in the designation of fund balance for capital project funding. On June 24, 2008, City Council amended the Debt Per Capita related guidelines.

These updated policies are as follows:

Debt as a Percentage of Fair Market Real Property Value
Target = 1.1 percent; Limit = 1.6 percent

This ratio indicates the relationship between the City's debt and the full value of real property in the City as assessed annually at fair market value. It is an important indicator of the City's ability to repay debt because real property taxes are the primary source of the City's revenues used to repay debt. A small ratio is an indication that the City will be better able to withstand possible future economic downturns and continue to meet its debt obligations.

~~Debt Per Capita as a Percentage of Per Capita Income~~
~~Target = 2.25 percent; Limit = 3.25 percent~~

~~This percentage is a measure of the capacity of citizens to finance tax-supported debt. A lower percentage means that taxes required to repay debt represent a smaller portion of the average citizen's income.~~

Debt Per Capita
Target = An amount equal to 3.2 percent of per capita income
Limit = An amount equal to 4.5 percent of per capita income

This ratio indicates the per capita debt burden and is a general indicator of the City's debt burden. A smaller ratio indicates a lighter burden. The debt per capita target is set on sliding scale so that growth in per capita income allows a gradual and equivalent increase in debt per capita.

Debt Service as a Percentage of General Government Expenditures
Target = 8.0 percent; Limit = 10 percent

This ratio is a measure of the City's ability to repay debt without hampering other City services. A small ratio indicates a lesser burden on the City's operating budget.

Unreserved General Fund Balance as a Percentage of General Fund Revenue
Target = Not applicable; Limit = 10 percent

Undesignated General Fund Balance as a Percentage of General Fund Revenue
Target = 5.5 percent; Limit = 4.0 percent

Unrestricted Net Assets as a Percentage of General Revenues
Target = 5.5 percent; Limit = 4.0 percent

These ratios indicate the ability of the City to cope with unexpected financial problems or emergencies. The Unreserved General Fund Balance represents the funds legally available to the City. It is desirable that the City maintain Unreserved General Fund Balance that is comparable to the ratio maintained by other double triple A rated jurisdictions, but not to fall below the limit of 10 percent. The Undesignated General Fund Balance corresponds to the checkbook balance of the City. Both balances are important to consider. The unreserved balance includes designations that the City Council has made but presumably could change.

Net assets corresponds to stockholders' equity for publicly traded companies. The larger the undesignated General Fund Balance or unrestricted net assets, the greater the City's ability to cope with financial emergencies and fluctuations in revenue cycles.

The ratios for undesignated general fund balance and unrestricted net assets are calculated after adjusting for the effect of subsequent year's expenditures, and funding for future equipment replacement and capital projects, grants and contributions restricted to specific programs, and extraordinary and special items.

The City will not issue tax or revenue anticipation notes to fund ongoing governmental operations. The City of Alexandria will manage its cash in a fashion that will prevent any borrowing to meet working capital needs.

The City will not issue bond anticipation notes (BAN's) for a period of longer than two years. If the City issues a BAN for a capital project, the BAN will be converted to a long-term bond or redeemed at its expiration, but will not be rolled over.

The City will continue to rely on current revenue, including its fund balance, to finance its short-lived and maintenance-oriented capital improvements. The City believes in funding a significant portion of capital improvements on a pay as you go basis; therefore, the City will continue to finance short-lived and maintenance oriented capital improvements with current revenues, and its fund balance. The priority to consider when additional General Fund revenues become available at the end of the fiscal year would be a designation within the General Fund fund balance for pay as you go capital.

The City will not establish a trend of using General Fund equity to finance current recurring operations. The City's General Fund equity has been built over the years to provide the City with sufficient working capital and to enable it to finance equipment replacement, capital projects, and unforeseen emergencies without borrowing. To conserve the General Fund equity balance and to avoid reliance on this balance, the City will not finance recurring operations from the General Fund equity balance for periods longer than two years as confirmed by the audited financial statements. If the audited financial statements confirm that recurring operations have been funded from the General Fund equity balance for a period longer than two consecutive fiscal years, then the City will adopt in its next ensuing budget a balanced budget in which the operating revenues meet the operating expenditures without any consideration of the General Fund equity balance.

The City will annually prepare a six-year capital improvement program. In accordance with the City Charter and in order to meet the debt ratio targets, to schedule debt issuance, and to systematically improve the capital structure, each year the City will prepare and adopt a six-year capital improvement program. This capital improvement program will identify the source of funding for all capital projects. The debt issuances that are a part of the capital improvement program will be structured to meet the City's debt policies and debt ratio targets.

The City Manager will prepare each year and submit a set of six-year scenarios of possible future revenues and expenditures that match the six year Capital Improvement Program time horizon with the proposed budget to be considered by the City Council. Those scenarios will be updated to reflect the decisions of the City Council and issued with the approved budget. In order to improve financial planning and decisions, the City Manager also will annually prepare with the approved budget a set of six-year scenarios of possible future General Fund revenues and expenditures and their effects on the debt-related financial policy ratios outlined above, including the effect of planned borrowing under the approved CIP.

In accordance with the Government Finance Officers Association budget review requirements, this table, taken from the City's FY 2007 Comprehensive Annual Financial Report, is repeated here:

City of Alexandria, Virginia
 Computation of Legal Debt Margin
 as of June 30, 2007

Assessed Value of Real property, January 1, 2007	\$34,243,031,000
Debt Limit: 10 Percent of Assessed Value	3,424,303,100
Amount of Debt Applicable to Debt Limit:	
General Obligation Bonds	<u>\$278,525,000</u>
 Total General Obligation Debt	 <u>(278,525,000)</u>
 LEGAL DEBT MARGIN	 \$ 3,145,778,100

Limitations on the Incurrence of General Obligation Debt:

There is no requirement in the Virginia Constitution, the Virginia Statutes or in the Charter of the City of Alexandria that the issuance of general obligation bonds of the City be subject to approval of the electors of the City at referendum.

Under the City Charter, the City Council has full authority to authorize and issue general obligation bonds. The authorizing procedure consists of the passage on first reading of an ordinance authorizing the issuance of the bonds followed by a notice of public hearing at a subsequent meeting and the final passage on second reading following the public hearing.

The only constitutional limitation on the issuance of general obligation bonds is contained in Article VII, Section 10 of the Virginia Constitution, which states that:

No city or town shall issue any bonds or other interest-bearing obligations which, including existing indebtedness, shall at any time exceed ten percent of the assessed valuation of real estate in the city or town subject to taxation, as shown by the last preceding assessment for taxes.